WILL YOUR NONPROFIT BE HERE NEXT YEAR?

Materials Prepared by:
LISA A. RUNQUIST,
CHERIE L. EVANS, &
BARRIE COWAN

KEEPING YOUR BOARD OUT OF TROUBLE: WHAT IMPLICATIONS DOES THE SARBANES-OXLEY LAW PASSED BY CONGRESS HAVE FOR YOUR NONPROFIT?

by

Lisa A. Runquist[1]

Board governance issues has been a hot topic for businesses. Nonprofits are not exempt from these issues. What implications does the Sarbanes-Oxley law passed by Congress have for your nonprofit? What have the states been doing in response?

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[1] **Lisa A. Runquist** is a principal in the law firm of Runquist & Associates, with offices in Los Angeles, California. She has 30 years of experience representing nonprofit organizations and is the first winner of the Outstanding Lawyer Award, a Nonprofit Lawyers Award presented by ABA Business Law Section. She has authored numerous publications on nonprofit and religious organizations, and has been active in nonprofit and exempt organization committees of both the American Bar Association and the State Bar of California Association.

The following is a synopsis of recent changes in laws and attempts to explain how the changes impact or should impact a well run nonprofit.

I. Sarbanes-Oxley

A. **Introduction**: The American Competitiveness and Corporate Accountability Act of 2002, commonly referred to as Sarbanes-Oxley or "SOX", represents the most radical single regulation of public companies since the '33 and '34 Acts. SOX is a response to mismanagement and, in some cases, outright fraud by corporate officers and is an attempt to legislate accurate and truthful reporting by public companies to their owners, the shareholders. However, SOX is not limited to public companies. Some provisions, such as protection of whistle blowers and prohibiting destruction of corporate records, apply to all entities, including nonprofits. Further, many states, including California, have enacted laws applying SOX-like provisions to nonprofit corporations. Finally, other SOX provisions may be applied to nonprofits through "best practices" emerging in response to SOX.

B. **Application of SOX to Publicly Traded Companies**: Most provisions in SOX apply to "issuers." The term 'issuer' means a company whose securities are registered with the Securities and Exchange Commission (the "Commission"), who is required to file periodic reports with the Commission or who has a registration statement for their securities pending before the Commission[2] (i.e., publicly traded companies or "public companies") and accounting firms that audit public companies.

1. Auditors: SOX established the Public Company Accounting Oversight Board (the "Board"), to oversee the audit of public companies. Accounting firms that audit public companies must register with the Board. The Board is required to establish auditing, quality control, ethics, independence and other standards relating to the preparation of audit reports of public companies, which must include requirements for: a second opinion of audit reports; auditor testing of internal controls and a description of material weaknesses in the internal controls; and rotation of the partner in charge of an audit at least every five years. SOX requires the Commission to promulgate rules making it unlawful for an officer or director of an issuer to fraudulently induce, coerce, manipulate or mislead an auditor. (H.R. 3763, Sec. 303.) SOX requires auditors to retain their work-papers and supporting records for 5 years; knowing and willful destruction of such documents is punishable by a fine and up to 10 years in jail. (18 U.S.C. §1520(a)(1); (b).)

2. Audit Committees: SOX requires issuers to have an audit committee, made up of directors that are independent, in the sense that they cannot receive compensation from the issuer except for services as a director and on board committees and they cannot be affiliated with the issuer or its subsidiaries. If an issuer does not establish a separate audit committee, the board of directors is the audit committee. The audit committee is responsible for the appointment, compensation and oversight of the auditors, who report directly to the audit

[2] "The term 'issuer' means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of the Act (at U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(e)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn." H.R. 3763, Sec. 2(a)(7).

committee. The audit committee must establish complaint procedures regarding audits, internal controls and auditors and must provide for anonymous submissions regarding questionable accounting and audit matters. The audit committee must have authority to retain advisers and the issuer must provide funding as determined by the audit committee to compensate the auditor and advisers retained by the audit committee. Issuers must designate a member of the audit committee as their "financial expert"[3] and disclose the expert's identity; or they must disclose why they have not designated an expert.

3. Chief Executive Officers and Chief Financial Officers: SOX requires an issuer's CEO and CFO to certify an issuer's annual and quarterly reports ("periodic reports"). (18 U.S.C. §1350(a).) The certifications must include that: they have reviewed the periodic report; they have no knowledge of material misstatements or omissions in the periodic report; and, to the best of their knowledge, the periodic report fairly represents the financial condition and operations of the issuer. In addition, they must certify that a periodic report containing an issuer's financial statements "fully complies with Sections 13(a) or 15(d) … [of the '34 Act] … and that information contained in the periodic report fairly presents, in all materials respects, the financial condition and results of operations of the issuer." (18 U.S.C. §1350(b).) A "willful" violation is punishable by a fine of up to $5,000,000 and up to 20 years in jail; a "knowing" violation by $1,000,000 and 10 years. (18 U.S.C. 1350.) In order to certify the periodic reports, the CEO and CFO must establish and maintain internal controls designed to ensure they are advised of material information. They must assess the effectiveness of the internal controls within 90 days of any certification and they must disclose their conclusions regarding the effectiveness of the internal controls. The auditor must attest to management's assessment of the internal controls.

If an issuer is required to restate its financial statements because of material noncompliance with financial reporting requirements under the securities laws caused by misconduct, the CEO and CFO must reimburse the issuer for any bonus or incentive based compensation they received from the issuer. Issuers must adopt codes of ethics for their senior financial officers or explain why they have not adopted such codes. Under SOX, debts resulting from violations of federal securities laws are not dischargeable in bankruptcy. (11 U.S.C. §523(a)(19).)

4. Conflicts of Interest: To promote auditor independence, SOX prohibits auditors from performing most types of non-audit services (such as bookkeeping, system design and implementation, appraisals and opinions, actuarial services, internal audits, and management, human resource or financial services) for its public company audit clients. Permitted non-audit services (such as tax preparation) by auditors must be pre-approved by the audit committee and disclosed to investors. Under SOX, an issuer's CEO, CFO and similar officers cannot have worked for the issuer's auditor during the previous year, if they participated in an audit of the issuer during such employment. With some exceptions, such as corporate credit cards and transactions in the ordinary course of an issuer's business, issuers may not extend or guarantee credit to directors or executive officers.

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3 A financial expert should have financial expertise, acquired through education or experience, that includes an understanding of GAAP and financial statements; experience in preparation or auditing of financial statements of comparable companies; accounting for estimates, accruals and reserves; experience with internal accounting controls; and an understanding of audit committee functions. H.R. 3763, Sec. 407.

5. Internal Disclosures: SOX requires auditors to disclose to the audit committee any alternative treatments discussed with management and all written communications between the auditor and management. The CEO and CFO must disclose to the audit committee and to the auditor any material weaknesses or significant deficiencies in internal controls; fraud involving any management or an employee with a significant role regarding internal controls; and significant changes implemented in internal controls.

6. Public Disclosures: SOX requires issuers to make real-time public disclosure of changes in financial condition or operations. In addition, issuers must disclose in their periodic reports their auditor's correcting entries and material off-balance sheet "transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses." (15 U.S.C 78m(j).) 23.

7. Destruction of records and protection of whistleblowers: Under SOX "Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined …, imprisoned not more than 20 years, or both." (18 USC § 1519.) With respect to issuers, SOX prohibits issuers from discriminating against employees, agents or contractors who disclose illegal activity, whether the disclosure is internal to a supervisor or external to law enforcement, or who participate in investigations or proceedings regarding such activity. (18 USC 1514A(a).) SOX also protects whistleblowers who assist law enforcement whether or not the disclosure is about a public company; specifically, "Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both." (18 U.S.C. 1513(e).) Under SOX, "Corruptly" tampering with a record or otherwise impeding an official proceeding is punishable by a fine and up to 20 years in jail. (18 USC 1512(c).)

8. Compliance: SOX requires the Public Company Accounting Oversight Board to inspect audit firms. Firms auditing over 100 issuers must be inspected annually and all others at least every three years. SOX also requires the Securities and Exchange Commission to review issuers' periodic reports at least every three years. SOX gives the Commission authority to prohibit persons who have "violated" 10(b) or 17(a)(1) of the securities laws from acting as a director or officer of an issuer. (15 U.S.C. §78u-3(f), §77h-1(f).)

C. **Application of SOX to nonprofit companies**: Some provisions, such as the prohibition on destruction of evidence in 18 U.S.C. §1518, the protection of whistleblowers in 18 U.S.C. §1513(e); and the prohibition against interfering with official proceedings in 18 U.S.C. §1512, apply to all entities, including nonprofits. In addition, provisions relating to conspiracies to commit fraud offenses and increased penalties for mail and wire fraud apply to all entities. (H.R. 3763, Sec. 902, 903.)

D. **Best Practices Emerging Post-SOX**: Although the majority of the laws and regulations coming from SOX do not, by their specific terms, apply to nonprofit corporations, SOX has had a significant influence on individuals and entities concerned with nonprofits, from grant making foundations to individual donors. In light of this influence, many SOX-like provisions may be unofficially adopted as “best practices” for all corporations, including nonprofits.

1. Because the suggestions in this section increase the potential exposure of officers and directors to liability, the board should procure and maintain officer and director liability insurance.

2. The board (or at least the majority thereof) should be independent and be informed of the corporation’s financial statements and operations. The board should adopt a written conflict of interest policy, requiring disclosure of potential conflicts of interest and exclusion of the interested individual from the deliberation and vote on the matter involving the conflict. The board should adopt a written code of ethics for all directors, officers, employees and volunteers of the corporation, including a prohibition against improperly influencing the corporation’s auditor or other corporate advisers. The board should adopt a written policy regarding loans to directors, officers and employees and should ensure that the corporation’s conflict of interest policy is implemented in any decisions regarding a loan to an officer or director. The board should adopt a written policy regarding document retention, to be implemented by the CEO and audited by the auditor as a part of internal controls.

3. If possible, the board should establish an independent audit committee. The board should designate at least one member of the audit committee (or of the board, if no audit committee is formed) as a financial expert and ensure that the individual is independent. The audit committee (or the board) should adopt a written policy for retention, independence and supervision of auditors, including whether and to what extent an auditor can perform non-audit services and rules relating to hiring executive officers that are employed by the corporation’s auditor. The audit committee (or the board) should ensure that the retainer agreement with the auditor includes an audit of internal controls within the scope of work and a requirement that the auditor retain its work papers for a term consistent with the corporation’s document retention policy. The audit committee (or the board) should establish complaint procedures, which permit anonymous submissions regarding questionable accounting, internal control and audit matters.

4. The corporation’s auditor must be independent of the corporation’s management, report to the board of directors and take responsibility for reporting irregularities in the corporation’s financial statements, operations and internal controls to the committee (or to the board). The corporation should consider requiring the auditing firm to rotate the partner in charge of its audit periodically and might even consider rotating auditing firms[4] periodically.

5. The CEO and CFO should establish and review the corporation’s internal controls and report on the same to the board. The CEO and CFO should review the corporation’s financial statements and certify to the board that, to the best of their knowledge after a

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4. SOX requires the Commission to study mandatory rotation of audit firms (i.e., to limit the number of years a firm can audit a particular issuer), which may result in a best practice for companies, including nonprofits. It should be noted that the original proposal of the California Attorney General, discussed below, called for such a mandatory rotation; due to objections from the nonprofit sector, this requirement was dropped.

reasonable inquiry, the statements present a fair and accurate representation of the corporation's operation.

6. The CEO should review and sign off on the corporation's tax returns. [5]

II. State Legislation

1. <u>Introduction</u>

Several states have enacted laws applying SOX-like provisions to nonprofits. The New York Attorney General, Eliot Spitzer, was the first to propose such amendments to state laws regulating nonprofit corporations.[6] Since that time, other states, including California, have enacted similar laws and regulations.

B. <u>Recent Changes to California Law – The Nonprofit Integrity Act of 2004 (Corporate Changes):</u>

On September 29, 2004, Governor Schwarzenegger signed the Nonprofit Integrity Act of 2004 (the "Act"), an Act sponsored by the California Attorney General. Although there were a number of changes from its first draft, the bill, as enacted into law, still contains significant regulatory and disclosure requirements for nonprofit corporations in California. Unfortunately, it is unlikely that the Act will increase actual enforcement due to the significant costs to the state of reviewing the reports in a meaningful way and the apparent lack of funding for such activities. In addition, the Act will impose a substantial burden on most nonprofit organizations in terms of time and money necessary for compliance and the significant responsibilities imposed on already burdened *volunteer* directors. The Act, as adopted, was opposed by most in the nonprofit arena. Although none of those opposing the law object to its purpose, rather they object to how the Act attempts to implement the purpose.

1. <u>What Is Covered:</u> The Act covers two basic areas: the first part makes changes in laws relating to corporate governance; the second part provides increased regulation of charitable fund-raising, both of the charities themselves and fundraisers that work for the charities. This portion of the discussion will focus on the changes in corporate governance.

2. <u>Who is Covered:</u> Some of the changes apply to all charities; while others apply only to selected organizations. For example, filing, registration and reporting requirements do not apply to government entities, religious organizations, cemetery corporations, educational institutions, hospitals, or health care service plans licensed under Section 1349 of the Health and Safety Code; and audit requirements (discussed more fully below), only apply to

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6. Although SOX does not require the CEO to sign a corporate tax return, this best practice may be found from the following language: "It is the sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation." (H.R. 3763- 63; Sec. 1001.)

7. See, Press Release, March 12, 2003, Attorney General Spitzer's Proposed Reforms to State Corporate Accountability Laws.

organizations with gross revenues in excess of $2 million per year.[7] Although it may not have been intended, it is possible that provisions not specifically excluded will apply to all nonprofits.

The Act makes it clear that the California Attorney General has oversight of unincorporated associations (such as limited liability companies and partnerships), as well as charitable corporations and trusts

3. Attorney General Oversight of Nonprofits: The Act requires the Attorney General to establish and maintain a register of charitable organizations and the basis upon which they hold charitable assets. To effect this, the Attorney General is given authority to conduct investigations and to "obtain from public records, court officers, taxing authorities, trustees, and other sources, whatever information, copies of instruments, reports, and records needed for the establishment and maintenance of the register." (Govt Code §12584.)

Organizations subject to the Act must register with the Attorney General within 30 days after they initially receive property. Thereafter, such organizations must file periodic written reports with the Attorney General, including information about the nature of their assets, the charitable purposes for which the assets are held, and their administration of the charitable assets. The Attorney General is required to issue regulations concerning when and how periodic reports will be filed and what information the reports will contain. The Act permits the Attorney General to classify organizations based on their purposes, the nature of their assets, their duration, the amount of assets held by an organization, the amount of assets devoted to an organization's charitable purposes, the nature of a charitable trustee or otherwise. The Attorney General may apply different reporting requirements to each classification.

4. Audit Requirements. Special rules apply to organizations subject to the Act that receive or accrue gross revenues of $2,000,000 or more, in a fiscal year. In calculating the $2,000,000 threshold, grants from, and contracts for services with, governmental entities are not included in gross revenues if the grantee organization is required to account to the granting agency for the funds received. Organizations with gross revenues of $2,000,000 or more, must:

a. Conduct an Annual Audit: An organization's financial statements must be audited by an independent certified public accountant in accordance with generally accepted accounting standards.[8] The audited financial statements must be available for inspection by the Attorney General and the general public no later than nine months after the close of the organization's fiscal year. Audited financial statements must be made available to the general public is the same manner as is required for IRS Form 990s. Organizations that are not required by the Act to have an annual audit, but voluntarily elect to have an audit, are subject to the same disclosure requirements of their audited financial statements as organizations required to have audits.

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[7] In calculating the $2 million threshold, charities can exclude government grants if they are required to account for the funds to the grant-making agency.

[8] Consolidated financial statements may be prepared covering a controlling organization and its controlled entities.

b. Adhere to Standards for Auditor Independence: For any non-audit services performed by an auditing firm, the auditing firm and its individual auditors must adhere to the standards for auditor independence set forth in the latest version of the Government Auditing Standards, issued by the Comptroller General of the United States (the "Yellow Book"). The Attorney General is authorized to impose additional standards for auditor independence that differ from the Yellow Book.

c. Create an Audit Committee: Nonprofit corporations must have an audit committee appointed by the board of directors. Generally, under California law, a board committee must be made up only of members of the organization's board of directors. The Act makes an exception for audit committees, permitting them to include non-board members. However, the organization's staff, including the president or CEO and the treasurer or CFO, may not be members of the audit committee. Unfortunately, in excluding specific individuals from participating on the audit committee, the Act does not distinguish between compensated officers (who are members of an organization's staff) and uncompensated board officers (who are volunteers), with the result that it is unclear whether an uncompensated board treasurer would be permitted to serve on the audit committee.

If an organization has a finance committee, it must be separate from the audit committee. Members of the finance committee may serve on the audit committee, as long as they constitute less than half of the audit committee; but the chair of the audit committee may not be a member of the finance committee.

No audit committee member may receive compensation from the corporation in excess of any compensation received by members of the board of directors for service on the board. As most directors do not receive compensation for their service, this limitation virtually requires the audit committee to consist wholly of volunteers. In addition, no audit committee member may have a material financial interest in any entity that does business with the charitable organization.

The duties of the audit committee[9] consist of:

i. Recommending, to the board, the retention and termination of an independent auditing firm.

ii. Negotiating the auditing firm's compensation on behalf of the board (this is optional);

iii. Meeting and conferring with the auditing firm in order to satisfy each member of the committee that the affairs of the corporation are in order;

iv. Reviewing and determining whether to accept the auditing firm's report;

v. Assuring that non-audit services performed by the auditing firm conform to the standards for auditor independence (see b., above); and

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[9] If a corporation is controlled by another nonprofit corporation the audit committee may be pay of the board of directors oft he controlling corporation.

vi. Approving the performance of non-audit services by the auditing firm.

5. Approval of Compensation: The board of directors or a committee thereof, or the trustee(s) of a charitable trust, must review and approve the compensation, including benefits, of the president or CEO and the treasurer or CFO, to assure that the compensation is just and reasonable. This appears to be required of all nonprofits, as there is no language that limits the section to organizations that are required to file reports with the Attorney General.

The board or a committee thereof must review compensation when such officers are hired, whenever the officer's term of employment is renewed or extended, and whenever the officer's compensation is modified (except for modifications to compensation that apply to substantially all employees, such as a cost of living increase).

6. Fundraising Changes. The Nonprofit Integrity Act also provides increased regulation of charitable fund-raising, both of the charities themselves and fundraisers that work for the charities.

Any commercial fundraiser is a person, other than the charity itself, who, either directly or indirectly, solicits funds, assets or property in the State of California, and receives or controls the solicited assets. Prior to soliciting funds, the commercial fundraiser must register with the Attorney General's Registry of Charitable Trusts. Renewals must be filed by January 15 of each year and are effective for one year. In addition, annual financial reports are due no later than 30 days after the end of the calendar year (e.g. by January 30), accounting for all assets collected. This report must include a detailed itemization of funds, assets or property solicited on behalf of each charitable organization or purpose, and must include total revenue, the fee or commissions charged, salaries paid by the fundraiser to its officers and employees, fundraising expenses, distributions made to the charity, and names and addresses of any director, officer or employee of the fundraiser who is also a director, officer or employee of the charitable organization for which the fundraiser solicted funds.

The law now provides that a commercial fundraiser is a constructive trustee and must account to the Attorney General for all funds collected. Not less than 10 days before any solicitation campaign, or not later than the commencement of emergency fundraising, the fundraiser must file a notice with the Attorney General listing the fundraiser and the charity involved, the fundraising methods to be used, the dates for the solicitation, and the individual supervising the solicitation.

Contract. There must be a written contract between the fundraiser and the charity for each solicitation, signed by the fundraiser and by "an official of the charitable organization who is authorized to sign by the organization's governing body." The contract must be available for inspection by the Attorney General and must contain specific information:

a. The legal name and address of the charity.

b. A statement of the charitable purpose for which the solicitation is being conducted.

c. A statement of the respective obligations of the fundraiser and the charity.

d. If a fixed fee is to be paid, a statement of the fee, along with a good faith estimate of what percentage the fee will constitute of the total expected to be received, along with disclosure of the assumptions on which the estimate is based. The assumptions must be based on all relevant facts known to the fundraiser.

e. If a percentage fee is to be paid, a statement of the percentage. This percentage shall be calculated by subtracting from contributions received not only the fee, but all amounts the charity is obligated to pay as fundraising costs.

f. The effective dates of the contract, and of the dates of the solicitation.

g. A provision that requires that each contribution in the control or custody of the fundraiser shall, in its entirety and within 5 working days of receipt, either:

i. Be deposited in a bank account in the name of the charity, and over which the charitable organization has sole control of withdrawals, or

ii. Be delivered to the charitable organization in person, by express mail, or overnight delivery.

h. A statement that the charity exercises control and approval over the content and frequency of any solicitation.

Note: The charity must actually establish and exercise control over the fundraising activities conducted for its benefit, including approval of all written contracts and agreements, and must assure that fundraising activities are conducted without coercion.

i. If the fundraiser proposes to pay a person for their attendance at or sponsorship, approval or endorsement of an event, the maximum dollar amount to be paid for this purpose.

j. A provision that the charity has the right to cancel the contract without cost, penalty or liability for a period of 10 days following the date the contract is executed, that the charity may cancel the contract by serving a written notice of cancellation on the fundraiser (effective 5 days from date of mailing), that any funds collected after effective notice that the contract has been canceled shall be deemed held in trust without the deduction of costs or expense, and the charity shall be entitled to recover all funds collected after the date of cancellation.

Note: This 10 day period cannot be waived.

k. Following the initial 10-day cancellation period, the charity may terminate the contract on 30 days written notice.

l. Following the initial 10-day cancellation period, the charity may terminate the contract at any time upon written notice, without payment or compensation of any kind to the fundraiser, if the fundraiser or its agents 1. make any material misrepresentations concerning the charity in the course of the solicitations, 2. Are found by the charity to have been convicted of a crime arising from the conduct of a solicitation for a charitable organization, or 3. Otherwise conduct fundraising activities in a manner that causes or or could cause public disparagement of the charity's good name or good will.

Note: If a charity cancels a contract under any of these provisions (j, k or l), it must mail a duplicate copy of the notice of cancellation to the Attorney General's Registry of Charitable Trusts.

Note further: Neither the charity nor the fundraiser may misrepresent the purpose of the charitable organization, or the nature or purpose or beneficiary of a solicitation. A misrepresentation may be found to have occurred by words or conduct or failure to disclose a material fact. Specific types of misrepresentations that are prohibited are set forth in the act.

m. Any other information required by the Attorney General.

Disclosure. A fundraiser must disclose the percentage of total fundraising expenses of the fundraiser, upon receiving a written or oral request from a person solicited. This must be disclosed in writing within 5 working days from receipt of the request by mail or facsimile, or immediately upon oral request, followed by written disclosure within 5 working days.

Restrictions. No person may act as a commercial fundraiser if that person, any director or officer of that person's business, any person with a controlling interest in the business, or any person the fundraiser employs, has been convicted of a crime arising from the conduct of a solicitation for a charitable organization.

The fundraiser may not solicit for a charity unless that charity is registered with or is exempt from registration with the Attorney General's Registry of Charitable Trusts. In addition, a charity may not agree to, or raise funds for another charity unless that charity is registered with or is exempt from registration with the Attorney General's Registry of Charitable Trusts or agrees to register prior to the solicitation.

A charity shall not enter into a contract with a commercial fundraiser unless the fundraiser is registered with the Attorney General's Registry of Charitable Trusts, or agrees to register prior to the beginning of any solictation. A contract between a charity and a commercial fundraiser is voidable by the charity unless the fundraiser is registered with the Attorney General's Registry of Charitable Trusts prior to the solicitation.

Records. Records must be kept for 10 years.

Fundraising Counsel. Similar requirements are provided for a fundraising counsel (someone who plans, manages, advises, counsels, consults, or prepares material for or with respect to a charitable solicitation).

C. <u>Proposed Changes to Other State Laws</u>

Various other legislative proposals have been introduced in various states. For example, in Massachusetts, "An Act To Promote the Financial Integrity of Public Charities" is currently before the legislature. This legislation, proposed by the Massachusetts Attorney General, would requires that a member of the board verify the accuracy of the charity's audit, that the officers have established controls over financial reporting, and that an audit be required of any nonprofit with income of $750,000 or more. It also prohibits charities from retaliating against an employee who submits a complaint to the audit committee, requires that compensation paid to employees be fair and reasonable, and prohibits insiders from receiving excessive benefits.

Generally, the various legislative proposals: 1. Require annual audits for nonprofits over a certain size; 2. Increase reporting requirements to the state Attorney General; 3. Provide for increased disclosure, reporting and regulation of fundraising activities; and 4. Require more active involvement of officers or directors, especially with regard to the financial affairs of the organization. See http://www.ncna.org for updated information about state legislation.

IV. Conclusion

As can be seen, the area of finances and compensation are a major emphasis both in SOX and in the new California law. Clearly a Board Audit Committee must be used. In addition, either an Executive Compensation Committee or the full Board must regularly review and approve the compensation of both the CEO and the CFO to determine that this compensation is reasonable. This is required by Federal Intermediate Sanctions law, the new California law, and proposed laws in other states.